THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CAREY M. FLYNT

DOCKET NO. 2007-5-G

Annual Review of Purchased Gas Adjustment and Gas Purchasing Policies of South Carolina Electric and Gas Company

DIRECT TESTIMONY OF CAREY M. FLYNT

FOR

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

IN RE: SOUTH CAROLINA ELECTRIC & GAS, COMPANY, INC.

PURCHASED GAS ADJUSTMENT ("PGA")

DOCKET NO. 2007-5-G

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Flynt. My business address is 1441 Main Street, Suite 300, Columbia, South Carolina 29201. I am employed by the State of South Carolina as the Program Manager of the Gas Department for the South Carolina Office of Regulatory Staff ("ORS").

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting from the University of South Carolina in Columbia in 1975. I was employed at that time in the electric and gas utility industry and gained twenty-five years of experience in this field. In mid October, 2004, I joined the South Carolina Office of Regulatory Staff in my present position. I have testified on numerous occasions before the Public Service

Commission of South Carolina ("Commission") in conjunction with natural gas issues.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. First, my testimony will address the historical review of the shortened six month period of September 1, 2006 through February 28, 2007. I will present ORS's findings and recommendations for South Carolina Electric and Gas Company ("SCE&G") or ("Company") regarding:

1) Natural gas commodity purchasing and capacity management of upstream transportation and storage assets,

2) The operation and continuation of the industrial sales program rider ("ISPR"),

3) The administration of the purchased gas adjustment clause ("PGA") and

4) The hedging program.

The second portion of my testimony addresses ORS's findings and recommendations regarding several changes or approvals the Company has requested. These requests include:

1) Changes to the PGA Tariff to be effective August 1, 2007. The Company is proposing to eliminate Rate 35 transportation volumes in the calculation of the Demand Cost of Gas ("DCOG") formula to eliminate un-recovered demand charges on a going forward basis,

2) Changes to the calculation of DCOG allocation factors to be effective August 1, 2007 in order to be consistent with the above PGA tariff change which eliminates Rate 35 transportation volumes from the DCOG calculation,

3) Approval of the Company's proposed method for the collection of the un-recovered amount of previous monthly demand charges and,

4) Approval of changes to the Rate 35 Transportation and Standby Service tariff sheet to require customers to make an annual contractual election, versus a monthly election, on receiving a) Transportation service only, b) Transportation service with Standby Sales Service or, c) Standby Sales service only.

Q. WHAT ARE ORS'S FINDINGS WITH REGARD TO THE COMPANY'S GAS PURCHASING POLICIES DURING THE REVIEW PERIOD?

A. For the two months of September and October, 2006, all gas supplies and transportation capacity assets were obtained as a bundled service from South Carolina Pipeline ("SCPC") under Commission approved tariffs and procedures. SCE&G's gas purchasing practices and policies were in accordance with Commission Order No. 2005-653 and enabled the Company to receive adequate supplies of firm gas to meet its customers' needs and to provide reliable service at costs consistent with Commission approved tariffs.

Beginning November 1, 2006 SCPC and SCG merged to become an interstate pipeline. In accordance with Commission Order No. 2006-679, for the four months of November 2006, through February 2007, SCE&G was responsible for purchasing its own natural gas commodity supplies and managing its own transportation and storage capacity assets. SCE&G made this major change without any disruption to its customers' service and without incurring any penalty charges. The same personnel, practices and procedures utilized by SCPC were utilized by SCE&G. It is ORS's finding that SCE&G was able to purchase physical delivery of natural gas commodity supplies and manage its transportation and storage capacity assets to meet its customers' needs and provide reliable service.

Q. DOES ORS BELIEVE THE COMPANY'S INDUSTRIAL SALES PROGRAM RIDER OPERATED PROPERLY AND SHOULD THE ISPR BE CONTINUED?

A. Yes. ORS found that the ISPR was operated properly and should be continued. ORS believes that this type of program or mechanism is required for a natural gas utility to effectively compete with alternate fuels in the industrial market. The Commission in its Order No. 83-876 dated December 28, 1983, in Docket No. 83-128-G, approved SCE&G's use of a Temporary Gas Cost Rider and most recently modified by Commission Order No. 2005-619. During the review period, SCE&G's ISPR customers' needs were supplied by SCPC for September and October 2006 and by SCE&G thereafter. The ISPR customers experienced no disruption of service or change from this transition. The ISPR has been regularly reviewed in each annual PGA and upheld consistently as beneficial for the system and all of its customers.

Q. PLEASE DESCRIBE THE COMPANY'S GAS COST RECOVERY PROCEDURES APPROVED BY THIS COMMISSION.

A. This Commission approved SCE&G's current gas cost recovery mechanism in Order No. 2005-653, dated November 8, 2005. In that order, the change to a two-part cost of gas recovery mechanism was approved. That mechanism involves a commodity component which is calculated to recover the commodity cost of gas purchased and a demand component which is calculated to recover the associated capacity cost of ensuring firm gas supplies can be delivered into SCE&G's system. The demand charges include the fixed charges by upstream pipelines for transportation and storage services.

Q. PLEASE DISCUSS THE OPERATION OF THE TWO-PART COST OF GAS RECOVERY MECHANISM.

A. All firm customers are charged the same Firm Commodity Benchmark cost. However, the Demand Charge cost component is calculated for each customer class (Residential, Small/Medium General Service, and Large General Service) based on a 50%-50% weighting of Peak Design Day Demand ("PDDD") and Annual Forecast Sales volumes. In computing the Demand Charge component, SCE&G's net revenues generated from interruptible sales and transportation service are credited against the net fixed upstream pipeline charges. In addition, credits are made to reflect the sales of upstream assets through capacity release markets. Added together, these two components, the commodity and demand costs, equal the PGA factor for each customer class.

Q. PLEASE DISCUSS THE CALCULATION OF THE MONTHLY OVER OR UNDER COLLECTION BALANCES OF GAS COSTS FOR FIRM CUSTOMERS.

A. The Company calculates monthly over and under collection balances separately for the Firm Commodity Benchmark and for the Demand Charges component. Each customer class carries forward its own net balance of over and under collections monthly. These calculations are filed with the

ORS each month and ORS presents its audit findings in each PGA proceeding.

Q. DOES ORS BELIEVE THE CURRENTLY APPROVED PURCHASED GAS ADJUSTMENT CLAUSE METHODOLOGY WHICH ALLOCATES DEMAND COST TO THE FIRM RATE CLASS SHOULD BE CONTINUED?

A. Yes. Currently the allocation of demand costs among the three rate classes are based on a 50%-50% weighting of Peak Design Day Demand and Annual Forecast Sales. However, ORS would like to point out that the Company should be required to recalculate the demand charge allocation factors for the classes twice during the remainder of 2007. The first re-calculation should occur if the Company's request to correct the PGA tariff effective August 1, 2007 is approved. The second re-calculation should occur if the Company's requested changes to the Rate 35 Transportation and Standby Sales Service tariff are approved. The Company should re-calculate the allocation of demand charges after these customers make their service election by October 15, 2007 so that those who elect to receive Standby Sales Service are included in the DCOG calculation. The Company has agreed to make these calculations.

Q. DURING THE REVIEW PERIOD, DID SCE&G FILE WITH THE COMMISSION MONTHLY CHANGES IN THE PGA FACTORS RESULTING FROM THE 12 MONTH ROLLING FORECAST OF GAS COSTS?

A. Yes. Under the provisions of Order No. 2006-679, SCE&G is allowed to make monthly adjustments in its PGA factors as supplier or capacity gas costs change after the Company completes an updated forecast if there is a "Material Difference" for any customer class equal to or greater than $0.01 per therm. These monthly PGA changes are stated in Mr. Roy Barnette's testimony.

Q. PLEASE STATE ORS'S OPINION OF SCE&G'S PURCHASED GAS COST FACTORS BEING CALCULATED EACH MONTH ON A FORWARD LOOKING TWELVE-MONTH PERIOD AND ALLOWING MONTHLY CHANGES TO THE PGA FACTORS TO CONTINUE.

A. ORS believes SCE&G's computation of its PGA on a rolling 12-month forecast and allowing changes to the monthly PGA factors should be continued.

Q. WHAT ARE ORS'S FINDINGS REGARDING THE COMPANY'S PURCHASED GAS ADJUSTMENT CLAUSE FOR THE REVIEW PERIOD?

A. ORS finds during the review period, SCE&G administered and recovered its gas costs consistent with the current Commission approved tariffs and Commission Orders.

Q. PLEASE DISCUSS SCE&G'S HEDGING PROGRAM.

A. While ORS is very concerned that SCE&G's hedging program added over $17 million to the cost of gas, ORS is also cognizant of several factors. First, as requested by the parties in PSC Docket 2006-5-G and approved in Commission Order No. 2006-679, SCE&G was authorized to implement a different hedging program. Specifically, the Company was allowed to replace its Kase hedging model with the Kase ezHedge model and dollar cost averaging with the expectation that the new procedures would better mitigate the impact of price volatility.

Second, as requested by the parties in PSC Docket 2006-5-G and approved in Commission Order No. 2006-679, SCE&G is authorized to hedge up to fifty percent (50%) of estimated gas purchases for firm customers beginning on and after November 1, 2006. Prior to Order No. 2006-679, SCE&G was authorized to hedge seventy-five percent (75%). SCE&G's volume available for hedging has been limited during the past four months as the reduction from 75% to 50% has been implemented. The volume for hedging has also been limited due the necessity of the hedging contracts purchased under the older Kase hedging model needing to expire in order to create available volume for hedging under the models implemented in Order No. 2006-679. As a result, approximately two percent (2%) of hedging in the review period has been conducted under the new models.

Third, the period under current review is shortened as a result of a request by the parties in PSC Docket 2006-5-G to change the annual Fall SCE&G PGA hearing to the Summer period previously reserved for the SCPC PGA hearing. The request was granted since SCPC will no longer be subject to annual PGA hearings as it merged to become Carolina Gas Transmission Company ("CGTC") which became subject to federal jurisdiction effective November 1, 2006. Accordingly, with the implementation of a summer hearing, the review period under this SCE&G PGA proceeding covers only four months in which SCE&G conducted its own hedging program, while future proceedings will cover a normal annual review period.

ORS is mindful that this shortened review period coupled with the implementation of new hedging procedures and hedging at lower volumes, has resulted in insufficient information necessary to evaluate the long term effectiveness of the hedging program. However, more information will be available at the close of the next review period from which to further evaluate the program.

SCE&G has agreed to continue reporting to the Commission and ORS monthly results of the hedging program.

Q. WHAT PROCEDURES WERE AND ARE IN PLACE TO ENSURE THAT NATURAL GAS SUPPLIES AND CAPACITY ASSETS ARE READILY AVAILABLE TO FIRM CUSTOMERS DURING EXTREMELY COLD WEATHER?

A. ORS had numerous discussions with SCE&G representatives regarding management of its supply and capacity assets. ORS reviewed the Company's contract levels for supply, transportation and storage. ORS believes SCE&G's operation met its firm customers' needs in a reliable manner during the review period and its plans show it should also be prepared to meet next winter's projected firm requirements. Also, SCE&G operates under an end user curtailment plan previously approved by this Commission. The curtailment plan limits purchases of natural gas by interruptible customers to a level that will not jeopardize the Company's obligation to serve its firm customers. Curtailments are determined by the category of service that a customer is purchasing under and identified in the Commission approved General Terms and Conditions accompanying each industrial customer's contract. There may be rare situations when supplemental deliveries of natural gas may be required to forestall irreparable injury to life or property including environmental emergencies. These deliveries defined as Emergency Service must first be approved by the Company and are exempted from curtailment.

Q. HAS ORS REVIEWED AND ANALYZED THE CAUSE OF THE UN-RECOVERED DEMAND CHARGES UNDER THE CURRENTLY APPROVED PGA TARIFF?

A. Yes. ORS has fully reviewed the PGA tariff and concurs with the Company that according to the Settlement Agreement in Docket 2005-113-G the Rate 35 Transportation volumes were included in the PGA tariff. This inclusion caused the volumes in the divisor for the demand charges to be overstated, thereby causing the demand charges to be un-recovered.

Q. FOR FUTURE MONTHS, DOES ORS BELIEVE THE COMPANY'S PROPOSED CHANGE TO THE PGA TARIFF TO BE EFFECTIVE AUGUST 1, 2007 WILL CORRECT THIS CONDITION?

A. Yes. It is the opinion of ORS that the proposed changes to eliminate the rate 35 transportation volumes from the calculation of future monthly demand charges as set forth in the PGA tariff being requested by the Company should correct this condition on a future basis.

Q. DOES ORS SUPPORT THE COMPANY'S PROPOSED METHOD OF ADDING THE UN-RECOVERED DEMAND CHARGES AMOUNT TO THE CUMULATIVE OVER/UNDER COLLECTION OF GAS COSTS, AND MAKING A

CORRESPONDING ADJUSTMENT TO CORRECT REVENUE IN THE JUNE 15, 2007 RATE STABILIZATION("RSA") FILING?

A. Yes. By making the accounting adjustments to increase the gas cost undercollection, which in turn increases sales revenue, this method will ensure that the Company will be allowed to recover its true actual cost of gas demand charges through the PGA mechanism, while also ensuring that these same costs would not be recovered through base rate revenue in the RSA filing of June 15, 2007.

Q. HAS ORS REVIEWED AND DOES ORS SUPPORT THE COMPANY'S REQUEST TO CHANGE THE RATE 35 TARIFF TO REQUIRE THESE CUSTOMERS TO MAKE AN ANNUAL ELECTION ON WHETHER TO RECEIVE TRANSPORTATION AND/OR STANDBY SALES SERVICE?

A. Yes. ORS recommends the Commission approve this change. By requiring the Rate 35 customers to make an annual election for the type of service they would like to receive, ORS believes this change would allow the Company to recover the demand cost of gas charges on a more appropriate cost causation methodology.

Q. DOES THIS CONCLUDE YOUR PREPARED TESTIMONY?

A. Yes, it does.